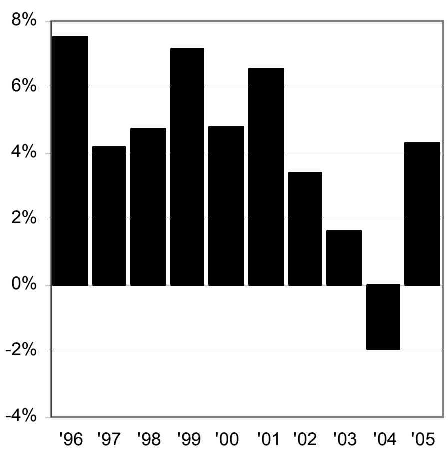
Revenue Estimates and Analysis

OVERVIEW

The FY05 Budget is supported with $1.906 billion in recurring revenue, an increase of $83.9 million, or 4.6%, from the FY04 Tax Rate Budget. The budget also includes $1.9 million in non-recurring revenue and $15.0 million from budgetary fund balance, yielding total revenue of $1.923 billion, an increase of $70.9 million, or 3.8% from FY04.

FY05 will represent a return to recurring revenue growth after a budgeted decline in FY04 (Figure 1.) The largest portion of the FY05 increase is attributable to growth in the Property Tax. Among all other major revenue categories, no items are projected to be less than that budgeted for FY04.

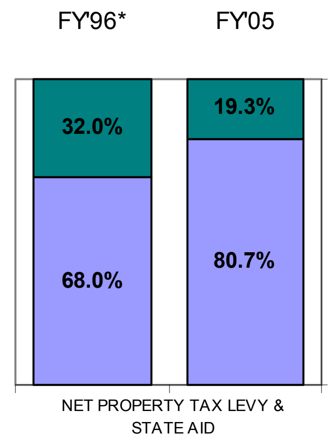


Annual Change in City Revenues

FY96 - FY05 Recurring Revenue

Figure 1

This chapter begins with a review of national and state economic trends that have and will continue to impact Boston in FY05 and beyond. It is followed by an analysis of recent state budget trends and state aid, the City's second largest revenue source. Finally, a detailed discussion of the property tax levy, the City's largest revenue source, is presented along with other City revenues. Net property tax and state aid together make up 80.7% of total City revenues and their stability is of critical importance in determining the City's ability to deliver quality services while maintaining fiscal stability and a balanced budget (Figure 2.).



Net Property Tax Levy and State Aid as a Percent of Total Revenue

**includes DHH*

Figure 2

THE NATION

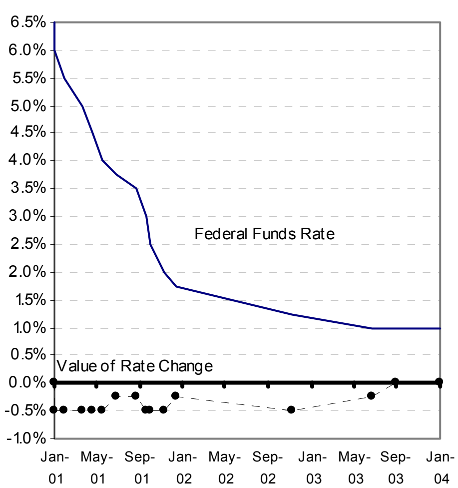
The United States economy is experiencing brisk Gross Domestic Product (GDP) growth despite a slack jobs market. Productivity growth and increased domestic investment have improved corporation balance sheets allowing replenishment of capital stocks – boosting GDP – without hiring new workers. The now familiar "jobless recovery" seems to be taking hold, however new jobs will need to be added rapidly in order to sustain the current recovery. Whether many new jobs will be demanded given the current strong productivity remains to be seen. In addition, there is still substantial excess capacity in manufacturing industries limiting the total demand for capital investment by firms.

The country dealt with the most recent recession as a small company might a hostile takeover attempt by a Wall Street giant – relying on the value in homes to sustain a level of consumer spending that dampened the overall effect of the downturn.

As a result, the recession was one of the mildest on record, lasting only eight months it is tied with the 1990-1991 and 1860-1861 recessions for the shortest duration in recorded history. And even as the uncertainty of terrorism warnings and the occupation of Iraq by U.S. forces has continued to weigh on confidence, Americans seem to be seeing past those issues to more favorable times ahead.

The retrenchment of the economy following the longest expansion in United States history had been less traumatic than expected with businesses quickly liquidating excess inventories, historically mild unemployment and consumer spending holding up through low interest rates and non-existent inflation.

Currently the Federal Reserve is maintaining an accommodative and stimulatory Federal Funds Rate at the June 2003, 41 year low of 1.00%. "Real" or inflation-adjusted short-term interest rates are near zero. The Federal Reserve has stated it will continue to use monetary policy to encourage economic expansion or thwart contraction. Since January 2001, the Federal Funds and Discount Rates have been cut thirteen times and by 550 basis points in total (Figure 3).



Federal Funds Rate and Changes
January 2001 - January 2004

Figure 3

The Federal Open Market Committee (FOMC) recently judged that the risks to sustainable economic growth are in balance. Currently, traders at the Chicago Board of Trade's Fed Funds Futures Market are pricing in a 0% probability of a Federal Funds rate increase at the May, 2004, FOMC meeting. In fact, traders do not anticipate any FOMC action until it raises the rate by 25 basis points in November 2004.

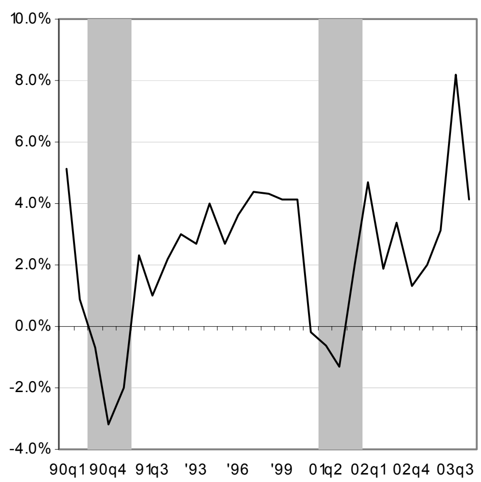
Higher interest rates slow the economy by making money costlier to borrow for purchases such as consumer durable goods and homes. Some evidence of effective monetary policy can be seen in the past two years of historically low interest rates that have spurred record car sales, home sales and home refinancings, this in spite of slack labor market conditions and the loss of stock market wealth. Higher interest rates will limit inflation as demand increases with a stronger economy.

Mortgage rates have continued to remain historically low due to a low Federal Funds rate. The monthly average conventional 30-year fixed-rate mortgage increased from a record low 4.60% in June 2003, to 5.36% in February 2004, very close to the rate a year earlier. Mortgage rates are expected to rise throughout the remainder 2004 and 2005 as the stock market recovers – drawing funds out of mortgage-backed bonds, inflationary price pressure builds, and the Fed Funds Rate increases.

Mortgage refinancings, which have fueled a great deal of consumer spending through lower monthly mortgage costs and "cash-out" refinancings, have slowed recently as mortgage rates that had been historically low, have begun to increase. Of the refinancings, the proportion of with a cash-out component is dwindling, however, as there is less equity to be drawn from home values, due partially to slowing appreciation and partially to the level of cash-out refinancing that has already occurred. Therefore, the positive effect on consumer spending is likely to be muted compared to previous periods.

The housing market, which likely kept the nation out of a deeper recession, is starting to slow, as mortgage rates rise. As should consumer spending on big-ticket, durable goods, as the main driver of that demand – home sales - has been muted, but the housing market should remain healthy enough, if less appreciable, for the foreseeable future increased employment moves in to shore-up demand.

Real gross domestic product (GDP) grew at 4.1% in the fourth quarter of 2003, half of the third quarter, but more than three times the 1.3% growth of the fourth quarter 2002. Real GDP is expected to increase at a brisk pace over the course of 2004. Current Federal Reserve estimates range from 4.5% to 5.0% annual growth by the end of 2004 after growth of 4.3% in 2003 (Figure 4.).



Real Gross Domestic Product Growth

1990-2003q4 and NBER Dated Recessions

Figure 4

The seasonally adjusted unemployment rate in the U.S. was 5.6% in January 2004, down slightly from 5.7% a year earlier and down slightly from 5.7% in December 2003 (Figure 5.). According to Federal Reserve forecasts, the unemployment rate is expected to decline from this level, ending the year between 5.25% and 5.50%, as businesses seek to increase their employment.

The U.S. consumer price index for all urban consumers (CPI-U) rose 1.7% in the year ending February 2004, down sharply from 3.0% for the year ending February 2003. The "core" rate of inflation, all items less food and fuel, slowed over the same time period to 1.3% growth from 1.8% the prior year. This moderate price pressure is evidence of rapid gains in productivity allowing lower selling prices and slack labor and product markets limiting demand of consumers.

Due to the recent poor health of the national economy, recent tax cuts and military action in the Middle East, the Federal Government expects to close FY04 (ending September 30, 2004) with a deficit at least as large as in FY03 ($375 billion).

Given this, anemic job growth figures, and the ambiguous projections of when balanced budgets or surpluses will return, the states should worry about less federal funds coming in the next year and possibly the following years until the economy fully recovers, spending priorities shift, and federal revenues stabilize.

THE COMMONWEALTH

The Massachusetts economy boomed in 2000. According to the Bureau of Economic Analysis (BEA), Massachusetts' real Gross State Product (GSP) ranked seventh among the fifty states in 2000 at 7.1% annual growth. Growth in the top ten states accounted for nearly 52% of GSP growth nationwide that year. BEA attributes much of the growth in the top Northeast states to strength in the Finance, Insurance and Real Estate, and Services sectors.

By 2001, annual Massachusetts real GSP had contracted by 0.4%. The decline in economic growth in Massachusetts that followed during this recent recession has been both better and worse that of the previous recession. For the better, is the absence of specific regional economic hindrances that weighed heavily on the state in the 1990's. Such things as strong house price appreciation are having a positive effect during this recession by using that higher than average appreciation to keep consumer spending afloat throughout the downturn and, a lower reliance on manufacturing industries hit hard nationally by excessive inventories and lack of pricing power. For the worse, is that the Massachusetts economy grew in 1990's through many businesses in the telecommunications, services and, specifically, financial services sectors. These sectors were greatly affected by the bursting internet-stock bubble.

The internet-stock market bubble greatly affected Massachusetts's income tax collections as well. For example, collections from wage and salary withholding taxes fell $600 million in FY02, while overall income tax from all sources fell nearly $2 billion. This demonstrates that not only did taxable incomes fall as a result of job losses, but also due to massive losses in investment income as well. It should be noted that several income related state tax cuts were still phasing in during this period, further exacerbating the decline in revenue. More detail on state tax cuts is provided further in this chapter.

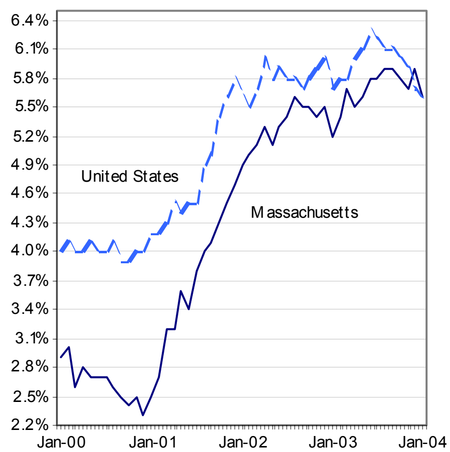
Massachusetts' seasonally adjusted total personal income grew by 1.2% in the third quarter of 2003 over third quarter 2002. This is positive but still fairly weak growth when compared to 2000 when annual personal income growth was over 11% in Massachusetts. Earnings growth by industry over the same third quarter time period were strongest in Educational Services, Real Estate and Healthcare, growing 11.4%, 8.8% and 7.6%, respectively. Earnings in Finance and Insurance and Information declined at rates of 0.5% and 6.4%.

Employment in Massachusetts continues to decline sharply as preliminary seasonally adjusted non-farm payrolls showed a loss of 48,400 jobs in January 2004, or 1.5% from the prior January, for a cumulative loss of 208,600 jobs or 6.2% since peak employment of February 2001 at 3,372,200 jobs. According to the Center for Labor Market Studies at Northeastern University, this is the highest proportion of jobs lost in any state in the nation.

Employment by sector has decreased most substantially in Manufacturing which lost 86,700 jobs since February 2001, or 21.2%. This was followed by Financial Activities, which lost 74,800 jobs or 14.8% and Trade, Transportation & Utilities, losing 32,000 jobs or 5.3%

The employment outlook is weak as well. Forecasts for Massachusetts from Economy.com project only mild employment gains in the first half of 2004 with increases in the second half and even then, only enough growth to end the year with a 0.3% gain over 2003. The seasonally adjusted unemployment rate for Massachusetts in January 2004 was 5.6%, up from 5.2% in January 2003, both of which are well above the ten-year low of 2.5% in October 2000 (Figure 5.).

After declining in the fall of 2002, the state seems to have regained some momentum in building activity. An index of the value of construction projects grew 27.8% in December 2003 after declining 13.5% in December 2002. The residential component (seasonally adjusted) increased rapidly, rising 57% in December 2003 after falling 14.2% in December 2002. The non-residential component recovered as well, growing 23% in December 2003 after falling 25.4% in December 2002. It seems clear that the strength



Unemployment Rates

January-00 - January-04
Seasonally Adjusted

Figure 5

in residential building contracts reflects a continued tight state housing market, and the rebound in business building a return to a minimum level of investment in large projects.

While low interest rates and continued demand for new homes has kept residential building strong, the extent of pent-up demand for new housing, as interest rates rise and unemployment lingers through the coming year, is likely near exhaustion. This could mean a pronounced slowing of residential construction until wage growth returns to form a new steady demand for housing (see *Boston's People & Economy* section of Volume I for detail on Boston's economy.).

THE COMMONWEALTH BUDGET

In the decade prior to FY03, the Commonwealth had been successful in balancing its budget, giving it the capacity to support an adequate and diversified local revenue base for municipalities. Recently, due to the national economic recession, the corresponding drop in state tax revenues left the state in need of making program reductions, drawing on reserves, increasing taxes and freezing tax cuts already enacted, and reducing local aid. Municipalities received reductions in FY03 local aid in July 2002 by way of gubernatorial veto of certain line items, then in the fall with cuts to grant accounts, and once again in the winter when the legislature granted the new Governor temporary control over large local aid accounts in order to offset a projected deficit in that year.

The state formulated an FY04 Budget amid ever-rising costs pitted against a stagnated tax base. In January 2003, the Governor released a budget plan that included massive change to the funding of local aid accounts and restructured state government in myriad ways in order to achieve balance. There was some controversy as to whether the Governor's plan could in fact eliminate a projected $2.5 to $3.0 billion structural deficit in FY04 without raising taxes or affecting core services. The legislature committed to work quickly to produce a plan of its own. The House budget was released the following April 23, and the Senate budget in early May. The Conference Committee Budget, the compromise between the houses of the Legislature, was sent to the Governor June 20th.

The result was a rejection of nearly all of the Governor's reform measures, including substantial changes to Local Aid funding. The FY04 budget included yet another reduction in Local Aid.

Beyond continued reductions in Local Aid, the City sees the ongoing need to seek alternative, more diversified revenue sources. To that end, the City has proposed, continues to support, several legislative changes to allow municipalities to generate more own source revenue.

Specifically, the Mayor last year filed legislation to enact a 1% local option tax on prepared food and beverages sold in municipalities in addition to the 5% state tax already in place. If the Legislature were to enact this legislation and the City Council adopted it, the City could recover an estimated $17 million annually. A meals tax is a good fit for what has become a strong tourist and travel economy in Boston. It would provide revenue growth at a nominal rate without a heavy burden on residents, tourists or travelers with the total rate of taxation remaining one of the lowest of any major City.

At the same time, the Mayor filed legislation to enact local option taxes on parking in commercial parking lots and on entertainment services such as concerts, sporting events and movies. The City, like other regional urban centers, expends considerable resources in traffic, police, fire and public works services in support of these businesses. But unlike other cities, Boston does not have any taxing authority to recover those costs. Together, these local option taxes could generate $22 million annually.

All of these measures were defeated in the Legislature for FY04, but the City remains active in support of there eventual passage and will continually stress the importance of a diversified and equitable revenue system for municipalities.

The Commonwealth has tended to build its budgets cautiously the last several years by being relatively conservative in its revenue estimates. This caution had been rewarded by the accumulation of reserves that have allowed the state more options in dealing with recent revenue shortfalls than those of the past. The state had nearly exhausted those reserves by the close of FY03 and is now starting to build them again. The FY05 Budget will most likely require the use of some portion of those reserves in order to balance.

With the Commonwealth running large budget surpluses 1990's, tax cuts occurred in rapid succession. In July 1998, the Legislature and the Governor worked out a tax cut that included a doubling of the personal exemption and a reduction in the unearned income tax rate from 12% to 5.95%. In the FY00 Budget, the Governor signed into law a reduction of the earned income tax rate from 5.95% to 5.75% over three tax years. The Governor's FY01 Budget recommended a reduction in the tax rate on earned income and the interest and dividend components of unearned income to 5.0% over three tax years, which was later passed by referendum in November of 2000. The FY02 Budget included the above rate cut and some smaller targeted tax cuts taking effect in tax year 2001 such as: a refundable local property tax credit for low income senior citizens, an increase in the residential rental deduction, a new deduction for charitable donations, and a credit for developers of low income housing. The Governor's FY03 Budget included the continuation of the voter-approved income tax rate reduction to 5.0% valued at $452 million in FY03.

In FY03, the legislature, instead of continuing tax cuts, voted to accept a tax increase package. Valued at $1.14 billion by the Massachusetts Taxpayers Foundation, the package included a freeze of the income tax rate at 5.3% ($215 million), reducing the personal exemption by 25% ($240 million) repeal of the charitable donations deduction ($190 million), an increase in capital gains taxes ($275 million), and a $0.75 increase in the cigarette tax ($220 million) along with other increases to fees for various licenses. The Governor vetoed these tax increases but enough support existed for a legislative override of that veto.

Even with the enacted tax increases, the FY03 budget was reduced several times during the course of the year as revenues failed to meet estimates. Most early reductions fell on executive branch agencies or grant accounts where the governor has the power to cut unilaterally. In January 2003, the new governor sought from the legislature temporary power to reduce local aid accounts normally under legislative control. The legislature granted that temporary power and local aid for FY03 was reduced statewide. The FY04 Budget then further reduced major Local Aid accounts again.

The Governor's FY05 proposed budget of $22.98 billion is an increase of about 5.0% over FY04 projected spending. The budget again relies on changes in state government organization in order to achieve balance. State government would be changed by a consolidation of transportation agencies, refinancing of the school building assistance program, and changing public construction rules. Local Aid would remain intact and funded near level with FY04 with only a small increase in Chapter 70 school aid.

STATE LOCAL AID

In FY03, the Commonwealth's annual expenditure for direct local aid statewide was substantially reduced twice. The first statewide reduction of a net $32 million dollars occurred in late July 2002, one full month into the fiscal year, and mostly as a result of vetoes by the Governor. The second reduction of $114 million occurred in January 2003, as a result of the Legislature granting the new Governor temporary power to make unilateral reductions to local aid accounts.

In the decade prior to FY03, Commonwealth officials, driven by practical considerations and availability of resources, reinstated increases in local aid in the form of aid earmarked for education. This period of increases followed three years of significant local aid reductions, which played a key role in the Commonwealth's return to a balanced budget after the last economic recession. The Commonwealth's annual expenditure for direct local aid statewide has increased from $2.32 billion in FY92 to $5.02 billion in FY03, an increase of 116%.

At the same time, Boston's share of local aid (net of reimbursement for teacher's pensions) increased 36.9%. The remainder of this section looks at Boston's experience with local aid in detail.

Local aid refers primarily to distributions from the Commonwealth to municipal general revenue for Chapter 70 education aid, additional assistance and lottery aid. The amount of these funds to be distributed is listed on each community's cherry sheet (a listing of a city or town's local aid that was formerly printed on cherry-colored paper) along with other relatively smaller Commonwealth programs such as library aid, school construction, transportation and other reimbursements, and highway funds. As mentioned above, due to state revenue shortfalls in FY03 and FY04, and a lingering structural deficit in the state budget, there is virtual certainty that local aid will not be increased in FY05.

The City has based its FY05 estimate of state aid on the Governor's FY05 Budget released in January and assumes only minor growth. The City received local aid (after adjusting for an accounting change in the treatment of Charter School Tuition) from the Commonwealth totaling $522.7 million in FY02, $476.6 million in FY03, and has a budget of $450.9 million in FY04. The City expects $451.1 million of local aid in FY05.

Since FY82, there have been three distinct phases in state local aid funding policy. From FY82 through FY89, local aid policy was essentially a revenue sharing response to Proposition 2 1/2, the statewide cap on local property tax rates and levies. A reasonable annual increase in local aid became an essential component in the financial planning for municipalities. The distribution between municipalities was based upon a relative measure of balance between local needs and local resources, and the revenue was distributed both in the Chapter 70 and additional assistance line items.

During the FY90, FY91 and FY92 budgets the governor and the legislature sharply reduced state revenue sharing with cities, towns, and regional school districts in order to help balance the state budget. Between FY89 and FY92, statewide cherry sheet aid declined $639 million or 21.5% while all other state spending increased by $1.5 billion or 15%.

Beginning in 1993 with the passage of the FY94 state budget, the Commonwealth embarked upon a multi-year commitment to increase and equalize funding for local education in its local aid distributions. During this period, Chapter 70 increased and additional assistance remained frozen. In general, state local aid during the FY94-FY03 period has been less favorable for Boston than the revenue sharing arrangement during the FY83-FY89 period. To illustrate, the City's total state aid between FY92 and FY03 grew $121 million or 36.9%, while its total state aid between FY82 and FY89 increased by $215 million or 111%. The City's expected FY04 state aid decrease of 10% across most accounts amounts to a reduction of $45.8 million or 10.2% from FY03 when factoring in increased charter school tuition. FY04 local aid to Boston represents an overall decrease to nearly the FY98 level of local aid to the City.

The expected state budget for FY05 increases statewide education aid by 2.3% from FY04. However, the City expects to receive none of that statewide increase. The City received Chapter 70 education aid totaling $205.6 million in FY02 and FY03. The City expects to receive $200.5 million in FY04 and FY05. FY00 was the last year of the statutorily established funding schedule for education reform. There has yet to be established a post-FY00 funding schedule. A vital component in the City's delivery of quality public education in the near-term is strong financial support from the Commonwealth.

A key component of the Commonwealth's education reform effort is charter schools. The current educational aid is delivered in tandem with state-mandated costs for charter schools. Charter schools, which are granted charters by the State Board of Education, are publicly funded schools administered independently from local school committee and teacher union rules and regulations. There are two kinds of charter schools, the Commonwealth charter school and the Horace Mann charter school. The former is a school outside the local public school system and the latter is part or all of a school in the public school system. Unlike a Commonwealth charter school, Horace Mann charter school budgets remain part of the public school budget. In addition to the Board of Education, the local school committee and local bargaining agent must approve Horace Mann charter schools.

There are currently twenty Commonwealth charter schools and two Horace Mann charter schools available to Boston resident students. There were approximately 4,026 Boston resident students attending Commonwealth charter schools in FY04 and the City expects that number to grow to approximately 4,792 in FY05.

Before FY99, all charter school tuition was drawn directly from the City's Chapter 70 aid. This draw on the City's education aid totaled $10.9 million in FY98. Under amendments to the charter school law, the Commonwealth, subject to appropriation, will pay to the City as reimbursement for Chapter 70 aid reductions 100% of tuition for new charter school students the first year, followed by 60% of tuition and tuition increases the second year, 40% of tuition and tuition increases the third year and 0% thereafter.

In FY03, the Commonwealth failed to appropriate funding for the charter school reimbursement, therefore the City has paid the full tuition cost of $32.1 million in that year. The Commonwealth's FY04 Budget included $4.9 million for Boston's share of the reimbursement on its $39.9 million tuition assessment, leaving a net cost to the City of $35 million in FY04. In FY05, the City has budgeted a $4.3 million reimbursement on a $46.9 million tuition assessment for a net impact of $42.6 million.

Lottery aid for the City, as for most municipalities, had grown steadily over the last few years as a result of a state decision to phase-out the lottery cap and revert to the practice of returning all lottery profits to the cities and towns. FY00 was the fifth and final year of the state's plan. The City's lottery aid was $63.1 million in FY00, $71.0 million in FY01, and $63.5 million in FY02. Lottery aid was level funded in the state's FY03 budget and then later reduced to $57.6 million after the Governor effectively capped Lottery aid to cities and towns, diverting the excess funds to the state. The City expects to receive $54.0 million in lottery aid in FY04 and FY05.

Under normal circumstances, the lottery formula is not favorable to the City because it distributes lottery aid increases based inversely upon each municipality's relative per capita property wealth. The City receives a smaller percentage share of lottery aid than its share of the state population, and dramatically less than the share of lottery proceeds derived from sales in Boston.

Nevertheless, lottery aid has been an important source of revenue growth, aiding the City's efforts to sustain adequate municipal services. Beginning in FY01, growth in the City's lottery distribution reflected only profit growth in the lottery and not the removal of the state cap on lottery aid that had been in effect the five years prior to FY01. Now that lottery aid is subject again to the state's discretionary capping or reducing, it may take several years before it is again restored as solely a local aid revenue source.

Additional Assistance, as mentioned above, had been frozen since FY94, with most local aid increases coming through Chapter 70 education aid instead. Its purpose and usefulness came into question during the FY03 state budget process when the governor vetoed $31 million from the statewide appropriation and the legislature failed to override that veto. Subsequently, the new governor, using his temporary local aid reduction powers, reduced additional assistance yet again in January 2002 by $73 million. As Boston receives over 40% of the statewide distribution of additional assistance, these reductions fell disproportionately on the City. The City received $206.6 million in additional assistance in FY02 and adjusted additional assistance of $175.1 million in FY03. The City expects additional assistance to be reduced to $164.2 million in FY04 and FY05. Additional assistance has been important to Boston in supporting schools, public safety, and other basic city services. Its continued reduction would seriously risk the City's ability to provide those services to residents and visitors alike.

PROPERTY TAX LEVY

The property tax levy has been the City's largest and most dependable source of revenue growth during the past 20 years. In FY04, the net property tax levy is $1.052 billion, providing 57.7% of all City recurring revenue, with an increase to $1.100 billion expected in FY05. According to current estimates, the net property tax levy will account for 57.7% of total recurring revenue in FY05.

The increases in the gross property tax levy have been steady and consistent from FY85 to FY04, ranging from $28 million to $63 million. However, because of the increasing property tax levy base, the $28 million increase in FY85 represented an 8.9% increase, while the $58.1 million rise in FY04 represented 5.6% growth. It is important for the financial health of the City that the property tax levy continue to grow, but its future growth, as explained in more detail below, is not guaranteed.

The difference between the Gross and Net property tax levies is due to a required "overlay reserve". The overlay reserve is a portion of the gross levy set aside to pay for abatements of tax bills that are contested. Until FY04, the City was required by Chapter 717 of the Acts of 1957 to reserve between 5% and 6% of the levy for this purpose. In FY04, the City petitioned the State Legislature to repeal the act and allow the state Department of Revenue to approve the City's reserve annually as it does with every other city or town in the Commonwealth. The act was repealed and the City has reserved 4% of the levy in FY04 and FY05. This 1% lower reserve amount has added approximately $10 million in recurring revenue to the operating budget starting in FY04 and is determined by the City Assessor each year according to his projected need to satisfy abatements.

Proposition 2 1/2 has been the overwhelming factor affecting the City's property tax levy since being passed in 1980. Proposition 2 1/2 limits the property tax levy in a city or town to no more than 2.5% of the total fair cash value of all taxable real and personal property. It also limits the total property tax levy to no more than a 2.5% increase over the prior year's total levy with certain provisions for new growth and construction. Finally, Proposition 2 1/2 provides for local overrides of the levy limit and a local option to exclude certain debt from the limit. The City of Boston, however, has not voted to either override the levy limitations or exclude any debt from the limit.

Proposition 2 1/2, as amended in 1991, allows growth in the levy beyond the 2.5% limit for any new properties and any increases in property valuations that are not related to municipal-wide revaluations. This limitation is more flexible than the original limitations on allowable new growth and has helped to strengthen revenue growth in a budget that does not have a very diversified revenue base.

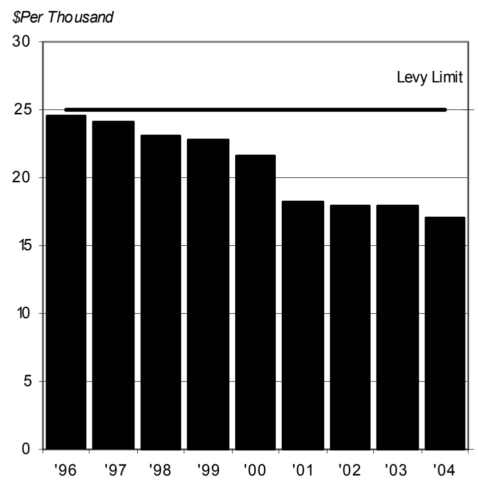
In each year since FY85, the City has increased its levy by the allowable 2.5%. These increases have grown as the levy has grown, beginning in FY85 at $8.4 million and reaching $25.9 million in FY04. During these same years, the levy has also been positively impacted by taxable new value, especially from new construction that has added to the tax base. The amount levied from taxable new value in FY04 was $32.8 million and is estimated at $22.5 million in FY05. The combined effect of the allowable 2.5% increase and the taxable new value is an average annual levy increase from FY98 through FY04 of $49.2 million or 5.6%, and a projected increase in FY05 of $49.8 million or 4.6%.

As real estate values decreased in the early 1990s, the City continued each year to maximize the allowable levy increase under Proposition 2 1/2. Between FY90 and FY94, the levy increased each year by an average of 6.4%. The dramatic decrease in values brought the effective tax rate (levy / taxable value) from its healthy low point of 1.4% in FY89 to 2.47% in FY94, dangerously close to the Proposition 2 1/2 tax rate ceiling of 2.5%. Reaching the 2.5% cap would have resulted in a very limited increase in allowable 2.5% annual levy growth. However, due to several years of strong taxable value increases, the City now has some space between its FY04 net effective tax rate of 1.71% and the tax rate ceiling. (Figure 6.)

Should the real estate market, which is still strong but slowing, suddenly depreciate again, the City's lack of proximity to the 2.5% property tax rate threshold should insulate revenues from an immediate shock but could, if values are depressed long enough, impair the growth of the property tax. This would have serious implications for the City's ability to maintain the current level of services in the future. The real estate market was healthy in 2002 and 2003 and should remain steady throughout 2004 and 2005.

OTHER REVENUE

Approximately 18.5% of the City's budget is comprised of Excise taxes, Fines, Payments-Lieu-of-Taxes (PILOTs), 121A Agreements, Investment Income, Miscellaneous Departmental Revenue, Licenses and Permits, Penalties and Interest, Available Funds, and Teacher's Pension Reimbursement. Some of these revenue streams are sensitive to economic conditions and can fluctuate significantly from year to year, and others are very stable, delivering predictable consistent annual revenues to the City.



Overall Property Tax Rate
FY96 FY04

Figure 6

The recent recession greatly affected the excise, interest on investment, and license and permit revenues of the City. Excise taxes were reduced by falling room occupancy and jet fuel revenue as the travel and tourism industries suffered through terrorism warnings and reduced corporate travel business. While motor vehicle excise had performed better due to zero percent financing from manufacturers on new cars, investment income suffered steep losses as reduced interest rates have suppressed earnings after several years of very strong gains. License and permit revenues, as a result of building permits, were strong in recent years due to strong commercial development in the City.

As the economy recovers there will likely be a reversal of recent history in excise tax and license and permit revenue collections. As interest rates rise, motor vehicle sales and construction will slow, but investment income and business travel will recover. The FY05 Budget reflects the beginning of this transition.

The remaining sources of other revenue to the City are based on agreements with non-profit institutions, contracts with urban redevelopment corporations, or set rates of fees, fine, penalty or interest. These endured the recession with little change in activity or revenue.

Overall, the City has experienced a reduction in other revenue over the past few fiscal years. In FY01 the City collected $372.0 million from these combined sources and $365.9 million in FY02. While in FY03 the City collected $377.3 million (some from one-time payments), the FY04 budget expects a steep decline to $319.2 million. The FY05 Budget assumes a partial recovery to $355.0 million.

The diversification of revenues in this category provides for an overall stable revenue stream to the City, as gains in some sources offset losses in others due to the competing economic variables that drive them. While there is fluctuation from year to year, overall, it is generally predictable and contained to a level where adjustments can be made without serious damage to basic City services. As mentioned above, the City has proposed additional local option excises to further diversify its revenue base and continues to review its fee and fine structure to ensure it receives the proper level of reimbursement of cost for the services it provides.

CITY OF BOSTON
REVENUE DETAIL

			FY02 Actual	FY03 Actual	FY04 Budget	FY05 Budget
	PROPERTY TAX LEVY		972,652,642	1,035,870,991	1,093,936,627	1,143,785,043
	OVERLAY RESERVE		(46,316,792)	(39,841,192)	(42,074,486)	(43,991,732)
		Subtotal	926,335,850	996,029,799	1,051,862,141	1,099,793,310
	EXCISES					
	Motor Vehicle Excise		42,764,112	45,576,419	33,848,939	36,500,000
40129	Room Occupancy Excise		20,975,953	18,000,000	18,000,000	20,500,000
40130	Jet Fuel Excise		16,221,475	18,839,212	10,500,000	13,000,000
	Other Excise		684,110	709,136	255,000	450,000
		Subtotal	80,645,651	83,124,767	62,603,939	70,450,000
	FINES					
	Parking Fines		56,524,172	55,326,949	56,500,000	58,500,000
45104	Code Enforcement - Trash		503,938	489,788	475,000	300,000
	Other Fines		3,730,549	3,492,307	3,150,000	3,255,000
		Subtotal	60,758,659	59,309,044	60,125,000	62,055,000
47151	**INTEREST ON INVESTMENTS**		14,800,359	8,552,002	4,200,000	7,300,000
	PAYMENTS IN LIEU OF TAXES					
40169	Massport		7,306,186	10,903,054	10,900,000	11,000,000
	Other Payments In Lieu of Taxes		10,960,514	11,179,994	11,280,661	11,756,512
		Subtotal	18,266,700	22,083,048	22,180,661	22,756,512
	URBAN REDEVELOPMENT CHAPTER 121					
	Urban Redev. Chap. 121B Sec. 16		1,350,019	1,564,463	1,530,494	1,500,000
	Urban Redev. Chap. 121A Sec. 6A		16,714,922	17,262,339	13,898,995	15,742,133
41013	Urban Redev. Chap. 121A Sec. 10		31,658,661	35,280,393	31,000,000	33,000,000
		Subtotal	49,723,602	54,107,195	46,429,489	50,242,133
	MISC. DEPARTMENT REVENUE					
43105	Registry - Vital Statistics		1,004,672	975,903	975,000	1,000,000
43109	Liens		880,825	1,163,650	800,000	800,000
43120	City Clerk - Fees		776,753	786,248	700,000	725,000
43137	Municipal Medicaid Reimbursement		16,571,169	17,620,082	10,500,000	11,000,000
43202	Police Services		476,466	749,735	480,000	480,000
43211	Fire Services		3,254,398	2,769,902	2,700,000	2,900,000
43301	Parking Facilities		1,988,112	1,848,419	1,500,000	1,450,000
43311	PWD - Street & Sidewalk Occupancy Fees		2,561,121	2,721,395	2,500,000	2,525,000
43797	PWD - Fiber Optic Rental Fees		289,523	522,035	250,000	500,000
44002	Tuition & Transportation - Schools		689,172	588,472	550,000	565,000
45106	Registry of Deeds Fees		2,505	0	0	0
47001	Telephone Commissions - City		23,351	30,067	25,000	35,000
47117	Worker's Comp. Reimbursement		4,095,694	1,316,802	0	0
47119	Settlements		1,359,069	1,205,885	700,000	715,000
47131	Pensions & Annuities		2,196,620	1,085,870	1,100,000	2,250,000
47132	Fringe Benefit & Indirect		1,257,007	1,850,000	500,000	1,850,000
47155	Prior Years Reimbursements		7,651,018	4,172,926	500,000	2,000,000
47157	Misc. Recovered Revenues		373	45,082	200	200
48000	Police Detail, 10% Admin. Fee		2,256,352	2,195,149	2,250,000	2,300,000
48003	Fire Detail, 10% Admin. Fee		263,137	318,713	265,000	285,000
	Other Misc. Department Revenue		6,444,796	3,264,769	2,873,150	4,042,632
		Subtotal	54,042,132	45,231,103	29,168,350	35,422,832

CITY OF BOSTON
REVENUE DETAIL

		FY02 Actual	FY03 Actual	FY04 Budget	FY05 Budget
	LICENSES & PERMITS				
40211	Building Permits	19,055,144	20,145,888	11,500,000	15,000,000
40213	Weights & Measures	162,240	232,144	200,000	225,000
40215	BTD - Street & Sidewalk Permits	1,603,688	1,633,634	1,400,000	1,600,000
40221	Health Inspections	1,116,240	1,099,087	1,050,000	1,065,000
40222	Alcoholic Beverage Licenses	2,303,108	2,280,043	2,200,000	2,215,000
40224	Entertainment Licenses	503,416	507,074	480,000	485,000
40225	Police & Protective Licenses and Permits	424,580	455,531	425,000	440,000
40229	Other Business Licenses and Permits	990,127	1,008,870	975,000	990,000
40235	Cable Television	3,236,361	2,607,867	2,600,000	2,900,000
	Other Licenses and Permits	237,783	176,257	200,000	430,000
	Subtotal	29,632,686	30,146,395	21,030,000	25,350,000
	PENALTIES & INTEREST				
40133	Penalties & Interest - Property Tax	1,672,085	2,075,795	1,500,000	1,500,000
40134	Penalties & Interest - Motor Vehicle Excise	2,852,381	2,937,443	2,850,000	2,850,000
40136	Penalties & Interest - Tax Titles	3,544,650	4,152,050	3,500,000	3,650,000
	Other Penalties & Interest	658	192	200	200
	Subtotal	8,069,774	9,165,479	7,850,200	8,000,200
	AVAILABLE FUNDS				
42502	Cemetery Trustee	1,778,400	1,849,004	1,932,385	2,029,004
42503	Parking Meters	2,790,000	10,000,000	10,000,000	10,000,000
	Subtotal	4,568,400	11,849,004	11,932,385	12,029,004
	STATE AID				
41015	State Owned Land	997,509	213,204	170,686	170,930
41101	R.E. Abatements - Veterans	531,201	465,986	465,986	464,028
41102	R.E. Abatements - Surviving Spouses	0	0	0	0
41103	R.E. Abatements - Blind	0	0	0	0
41104	Elderly Exemptions	0	880,051	386,083	454,310
41111	State Lottery Local Aid	63,492,321	57,555,789	53,968,473	53,968,473
41112	Highways	209,119	0	0	0
41114	Veterans Services	843,954	1,210,070	1,105,561	1,788,743
41116	Additional Assistance	206,638,214	175,126,364	164,211,152	164,211,152
41119	Racing Taxes	489,444	478,153	700,000	688,333
41301	School Construction	17,128,745	17,232,498	16,713,595	16,787,162
41305	Charter Schools Reimbursement	8,248,839	0	4,914,643	4,285,717
41306	Chapter 70 Education Aid	205,643,453	205,643,453	200,498,366	200,498,366
41307	Charter Schools Tuition	0	0	0	0
41311	School Transportation	10,357,059	10,448,750	0	0
41316	Tuition for State Wards	1,618,855	0	0	0
41117	Police Career Incentive	6,460,404	7,341,643	7,800,000	7,799,057
	Subtotal	522,659,117	476,595,961	450,934,545	451,116,271
41115	**TEACHERS PENSION REIMBURSEMENT**	45,340,542	53,727,847	53,683,909	61,389,720
42504	**BUDGETARY FUND BALANCE**	0	0	25,000,000	15,000,000
42501	Surplus Property	0	13,000,000	4,876,000	1,876,000
	GRAND TOTAL	1,814,843,472	1,862,921,644	1,851,876,619	1,922,780,982